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The Conference Board

Global Economic Trends:
What Lies Ahead for the '90's

In the decade ahead, international business will face:

- *New Global Competitors*
- *The Growing Integration of World Markets*
- *Ongoing Population Pressures*
- *The Continuing Problems of LDC Debtors*

Research Report No. 932

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The Conference Board, Inc.
845 Third Avenue
New York, New York 10022
(212) 759-0900
RCA International Telex
237282 and 234465

The Conference Board, Inc.
Avenue Louise, 207 - Bte 5
B-1050 Brussels, Belgium
(02) 640 62 40
Telex: 63635

The Conference Board, Inc.
1755 Massachusetts Avenue, N.W.
Suite 312
Washington, D.C. 20036
(202) 483-0580

The Conference Board of Canada
255 Smyth Road
Ottawa, Ontario K1H 8M7
(613) 526-3280

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Global Economic Trends:
What Lies Ahead for the '90's

by

John Hein

A Chartbook from The Conference Board

Contents

Foreword 3
Population 4
Gross National Product 6
Services 8
World Trade 10
Global Payments Imbalances 12
Exchange Rates 14
World Financial Markets 16
Developing Countries' Indebtedness 18
Financial Flows to Developing Countries 20
Multinational Corporations 22
References 24

Foreword

As the world's business leaders gather in San Francisco for the ninth International Industrial Conference, the world economy is about to complete seven years of uninterrupted expansion. This has been accompanied by rapid growth in world trade; an explosion in global financial markets; and an overall decline in the debt-to-exports ratio of the developing countries.

Inflationary pressures have induced some industrial countries to tighten their monetary stance, reversing the 1984-1987 decline in world interest rates; the adjustment of the major countries' external imbalances has slowed and threatens to halt in 1989; and a number of developing countries have experienced slower growth and rising debt-service burdens. Finally, trade barriers and protectionist threats continue to constrain the world economy.

This report portrays in both charts and text some features of today's global economic environment. The charts highlight significant shifts over the past eight to ten years to emerging economic trends. The text provides a series of background essays on major issues and problems. All the subjects covered—whether population, trade, or financial markets—bear directly on world economic growth and on the outlook for all who compete in the global marketplace.

Preston Townley
President, The Conference Board

William F. Miller
President, SRI International

Population

Over the past 30 years, the world's population has grown at a remarkably rapid pace—from 3 billion in 1960 to the current 5 billion mark. And that rate is accelerating. According to the latest United Nations projections, world population will reach 6 billion by the year 1999, and eleven years later, in 2010, it will exceed the 7 billion mark. Thereafter, the pace of population growth will abate somewhat, largely the result of declining global fertility rates.

These trends are characterized by noticeable differences among countries and regions. While world population is estimated to be increasing at a rate of 1.63 percent a year in 1985-90, the rate is highest in Africa (3.0 percent) and lowest in the developed countries (0.6 percent). In numbers, these rates imply 18 million additional persons per year in Africa, compared to 7 million in the developed countries. Forty-two countries, mostly in Africa and Western Asia, have an estimated annual population growth of 3 percent or more. By contrast, growth rates of 1 percent or less are estimated for 48 countries, mostly in Europe and North America, with 7 of these having a negative rate.

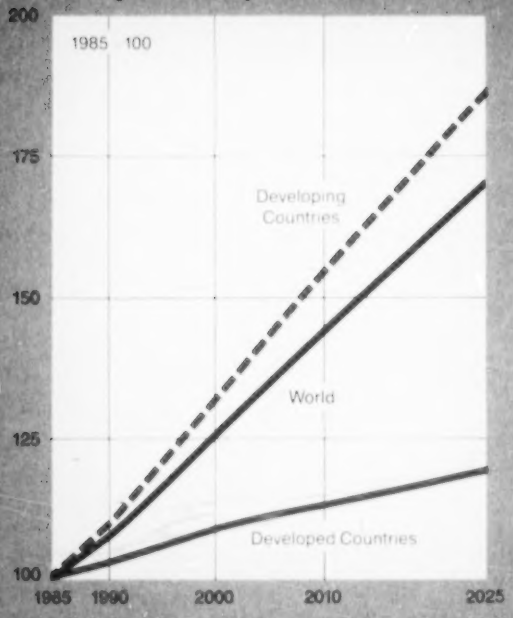
In 1985, half the world's population was under 23.5 years of age. But as a result of anticipated reductions in global fertility rates, combined with increases in worldwide longevity, the median age for the world as a whole is expected to rise to 26.5 in 2000 and reach 31.2 years by 2025. A major consequence will be a change of the balance between the number of persons of working age (15-64 years) and the dependent population, i.e., children up to 14 and those aged 65 years or more. This "dependency ratio," estimated at 65 per 100 persons of working age in 1985, is expected to decline sharply to 59 by 2000, and further to 53 by 2025. However, this overall trend masks differences between the developed regions, where the ratio will increase slowly, and the developing ones which will experience a significant decline.

Another noteworthy trend is the increasing urbanization of the world's population. In 1985, over 40 percent of population were urban residents; this ratio is expected to rise to 50 percent by 2010. Again there are differences: In the developed regions, urban dwellers are expected to increase from 71 percent of the total in 1985 to 74 percent by 2000. In the developing regions, the ratio is expected to rise from 31 to 39 percent over the same period. By the year 2025, urbanization in developing countries is projected to reach 56 percent—a level equivalent to that found among the developed countries in the mid-1950s.

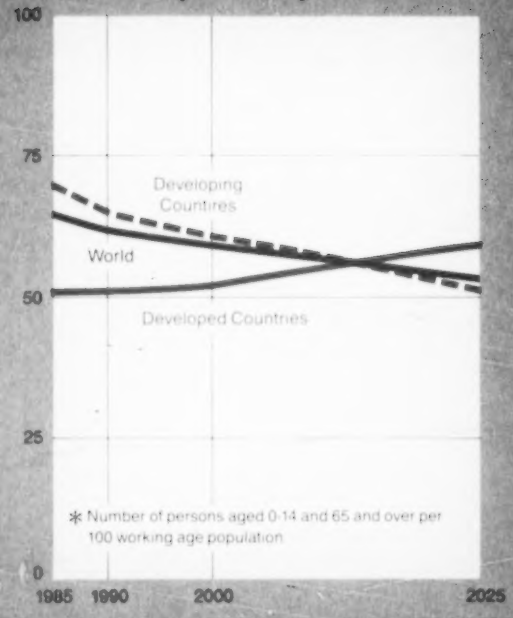
Source: United Nations

Source: United Nations

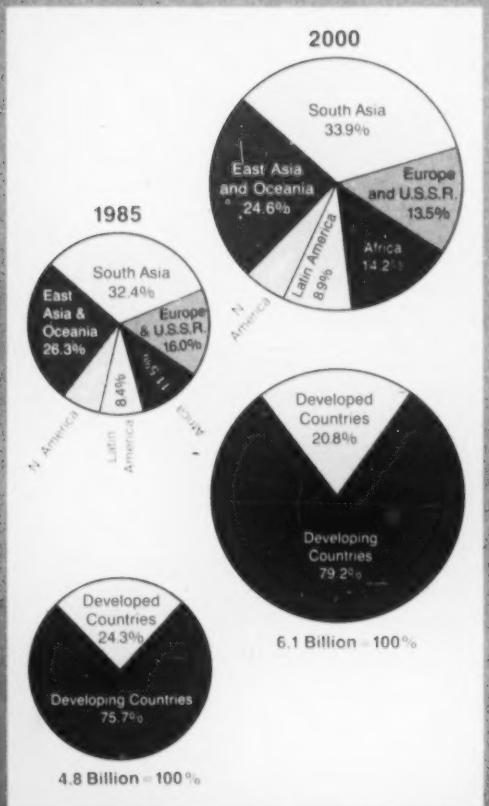
Projected Population Growth



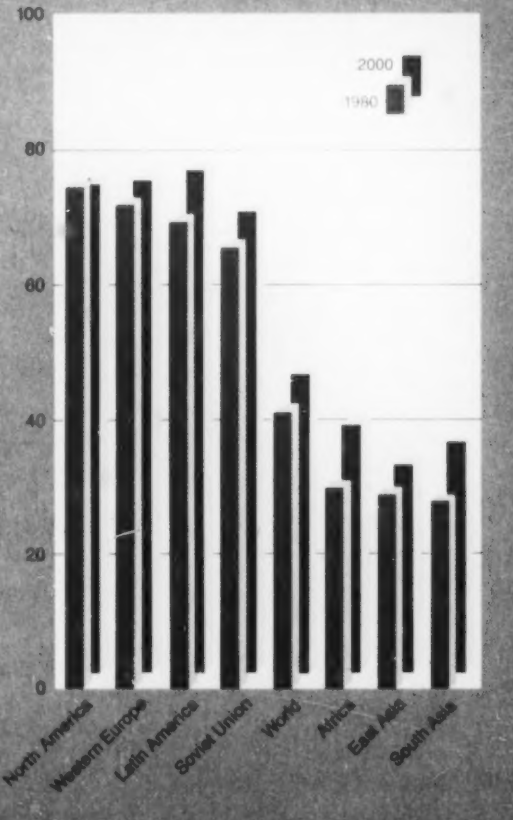
Dependency Ratio*



Population Distribution



Urban Population
(Percent of Total Population)



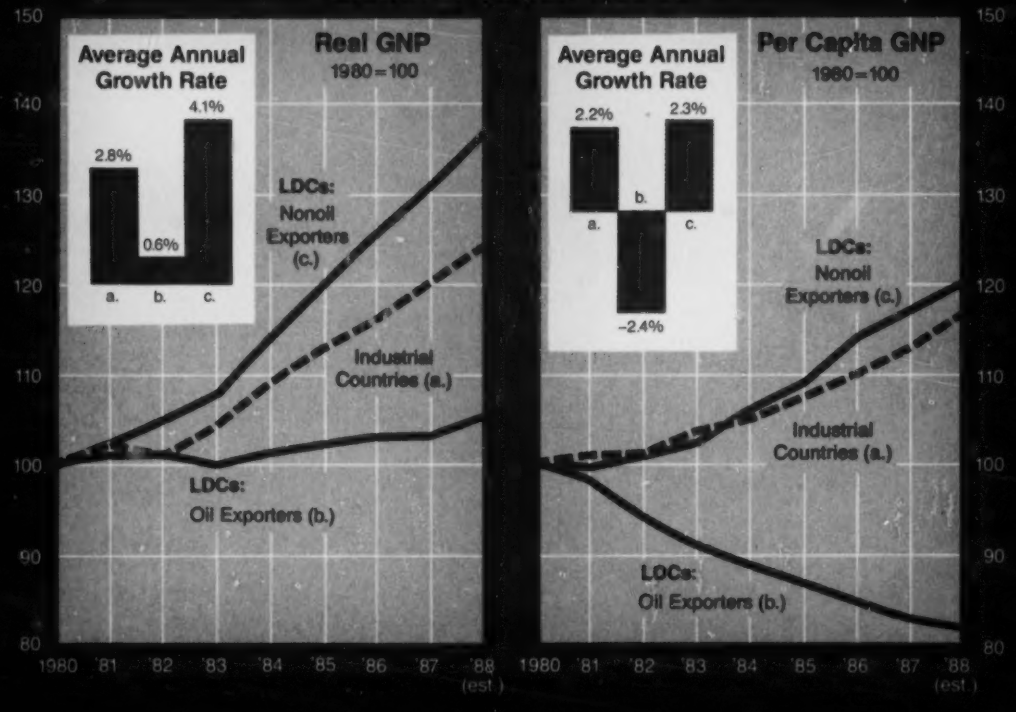
Gross National Product

At the beginning of the 1980s, close to four-fifths of the world's total output was produced in the industrial countries, which contain about one-quarter of the world's population. In stark contrast, 5 percent of global output was shared among the 47 percent of population living in low-income countries, such as Bangladesh, China, India, Pakistan, and most countries of tropical Africa.

On a per capita basis, GNP increased during the 1980-1987 period at an annual rate of 3 percent or more for 23 countries containing over 1.4 billion people. At that rate, the output of goods and services would double in approximately 24 years. For 35 countries with a combined population of over 2 billion, output per capita rose between 1 and 3 percent annually over the seven-year span. But for some 250 million people (in 24 countries), it rose by less than 1 percent a year, while for another 700 million, mostly in Africa, per capita GNP actually fell.

Although it would appear, therefore, that a large part of the world's population is better off (even if only slightly) than at the beginning of this decade, for many the actual gains have been small. Moreover, large absolute differences in average income between countries not only persist, but have increased in some cases. For example, between 1980 and 1987, per capita GNP in the United States grew at an average 2.1 percent a year, to $18,430. Over the same period, per capita GNP in India grew at

Growth of Output, 1980-88

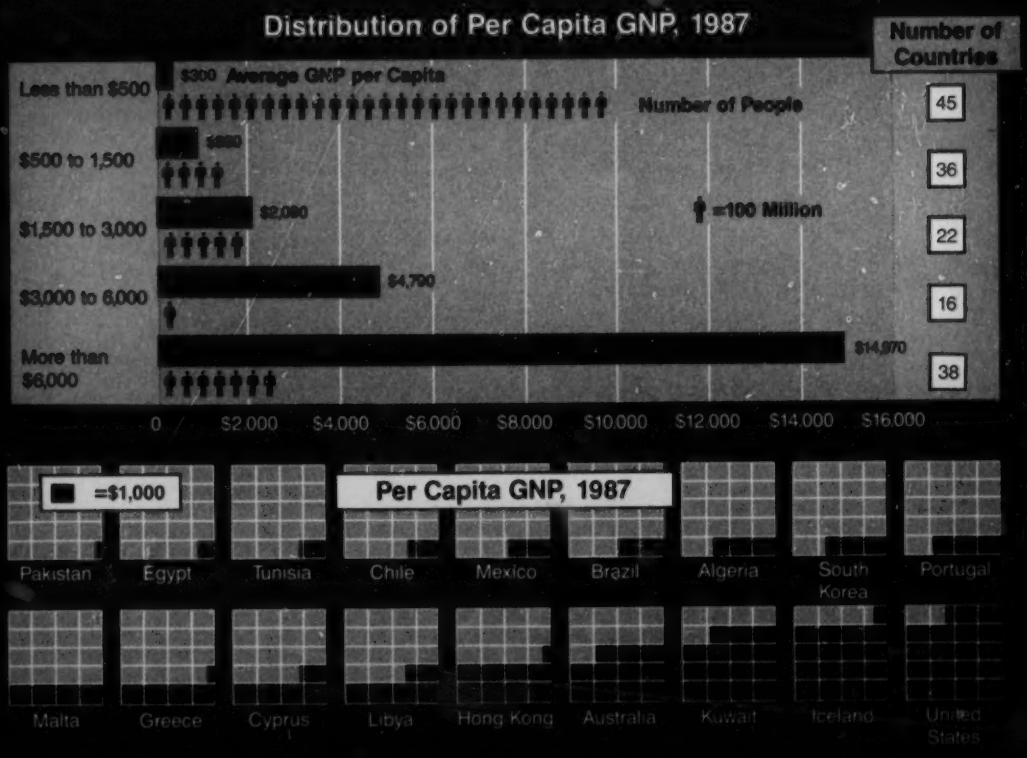


about 2.6 percent annually, but only to $300. Because of the large differences at the outset, U.S. per capita income had risen from 50 times India's to over 60 times by the end of the period.

Put in a global context, in 1987 over one half of the world's population was living in countries with an average per capita GNP of around $300. That is close to one-fiftieth of the average $14,970 for countries holding only one-seventh of the population. Of course, such comparisons are beset by statistical pitfalls. They tend to exaggerate the differences between rich and poor countries because both incomes and prices, especially for services, are lower in poor countries. But even with appropriate adjustments, the per capita income gap between the poorest and the richest has widened over time.

The World Bank's latest growth scenario to 1995 projects real per capita GNP growth of 1.8-2.6 percent for the industrial countries and 2.2-3.6 percent for the developing world as a whole, with considerably higher rates for the low-income countries. But given the already substantial differences in absolute levels between the two, the gap in income levels is bound to remain, if not widen.

Source: World Bank



Services

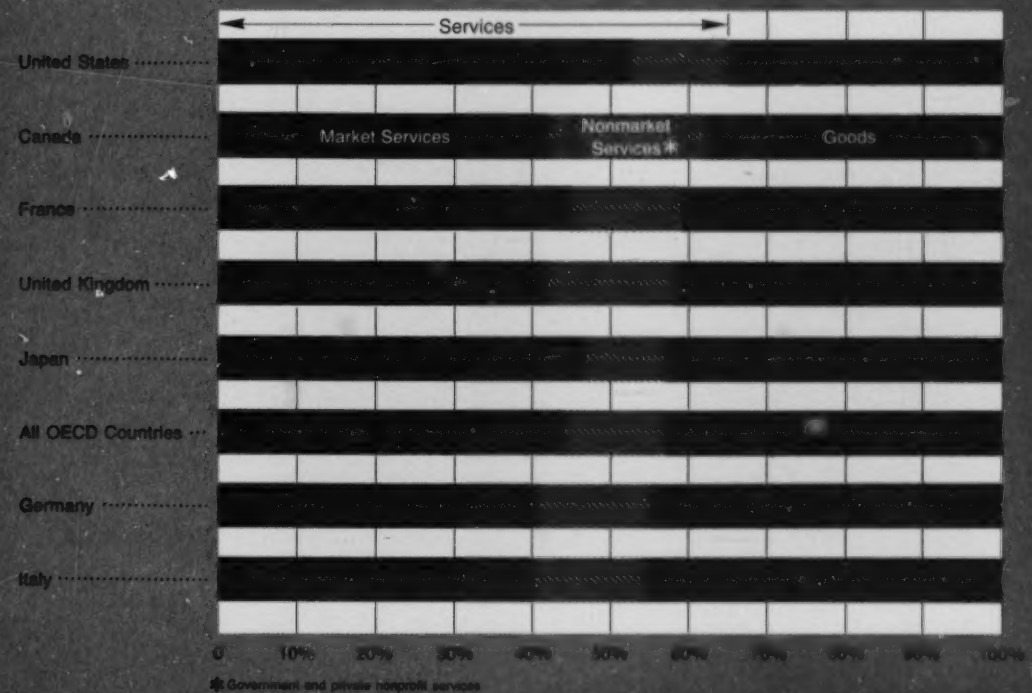
The impression that most of the industrial countries have become service economies conjures up the specter of widespread deindustrialization. However, this image is somewhat misleading, since the term "services" includes a wide range of activities, from investment banking to social and personal services.

A recent OECD study distinguishes between market or business-related services, such as finance, insurance, and other trade-connected activities, and non-market services, such as government and nonprofit activities. Such a distinction produces an entirely different picture and affects the degree to which individual countries may be classified as service economies.

Thus, the study found that for 22 of the OECD member countries goods and genuine market services contributed roughly equal amounts—between 40 and 44 percent each—to both value added and to employment. The study also found that relatively few countries would qualify as authentic service economies—that is, those in which value added in market services exceeded value added in the goods sector. Under this criterion, only eight countries would qualify as service economies, including the United States, Canada, and Japan.

The vision of an economic landscape dominated by fast-food places and video arcades and the idea that manufacturing can no longer serve as the backbone of a

Shares of Major Sectors in Gross Domestic Product, 1980-84 Average

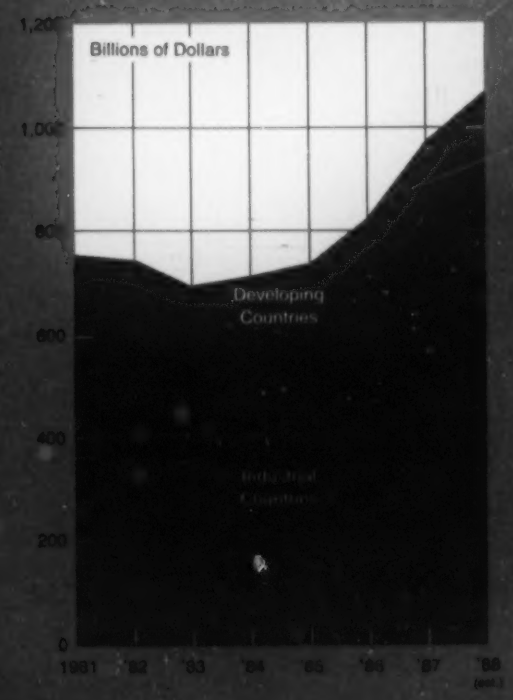


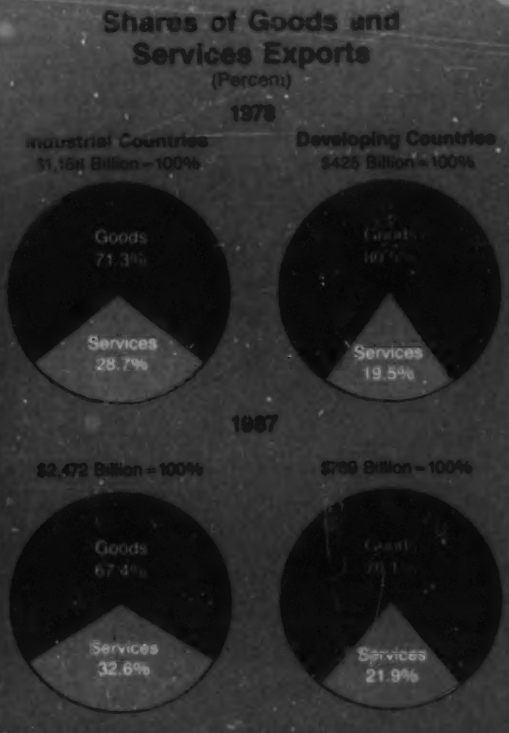
prospering economy must therefore be treated with some skepticism. First, while some market services cater primarily to household consumption, a sizable chunk of services is closely linked to the production of goods. Much of the growth in this kind of services and the often commented upon decline in the employment share of manufacturing actually are a function of business firms "farming out" service activities formerly performed in-house.

For the OECD countries as a group, services directly linked to goods production were found to account for 25 percent of total value added. Thus, production of both goods and ancillary services accounted for over two-thirds of gross national product. Similarly, about three-fifths of all jobs were linked to the production of goods.

Services likewise have become an important part of world trade. Over the past ten years or so, trade in services has expanded faster than trade in goods and for many countries now accounts for a considerable portion of total trading activity. (It should be noted, however, that in balance-of-payments accounting, "services" include investment income.) Thus, in 1986 half of total British exports fell into the services category, reflecting the United Kingdom's role as both a financial center and a major international creditor. Austria, with the second highest share of services in exports among the industrial countries, owes its ranking to tourism.

Sources: International Monetary Fund; OECD





World Trade

Six consecutive years of growth have brought the volume of world trade to a record level of close to one-third above the recession level of 1982. In 1988, the volume of world merchandise exports expanded by 7-8 percent, while the value of trade expanded by 12 percent to $2.6 trillion.

Just as after earlier business downturns, merchandise trade has recovered more rapidly than world output. In each of the past three years, for instance, the growth in trade volume has considerably exceeded the more or less stable rate of 3.0-3.5 percent annual growth in world production.

At the same time, this upsurge contributed to—and perhaps even consolidated—major changes in world trading patterns under way for the past ten to fifteen years:

- Products traded reflect a general shift away from basic goods, such as iron, steel, and paper, to high-tech items, such as electronics and telecommunications equipment. Thus, in 1986, office machines and data-processing equipment ranked third among internationally traded product categories, up from 20th place in 1973, while transistors and valves moved from 48th to 15th place.

- A number of Asian countries, especially the so-called newly industrializing countries (NICs), are now in the top ranks of world exporters. Between 1973 and 1987, Hong Kong doubled its share of world trade in manufactures, while Korea and Taiwan tripled their shares.

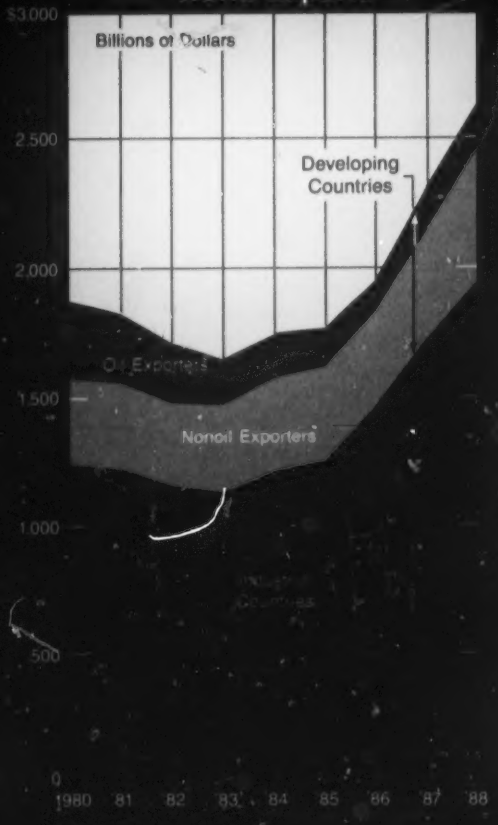
These changes are likely to continue and even intensify between now and the year 2000. They will coincide with significant shifts in population patterns between the industrial and the developing countries (see page 4) and with continued rapid technological progress. New and evolving technologies—including biotechnology, laser technology, optical fibers, and energy and space technology—are promoting product innovation, broadening the scope of product diversification in international trade. These new opportunities are enhanced further by major advances in transportation, which tend to reduce the cost of moving goods internationally. At the same time, advances in telecommunications are stimulating the growth of trade in services and of global financial markets.

At the level of the individual company, all these changes are working to internationalize production and distribution—to create the global factory—and are spawning many small- and medium-sized firms whose economic health now depends on the availability of worldwide markets. This factor explains, in part, why trade has tended to increase more rapidly than world output.

As the GATT notes in its 1987-88 review of world trade, the globalization of production and markets tends to increase the cost of nontariff barriers to trade, even if the level of these barriers remains unchanged. The report warns that "the resulting loss of economic efficiency is particularly damaging at a time when the challenges posed by worldwide population trends make higher rates of economic growth...more important than ever."

Sources: GATT, International Monetary Fund

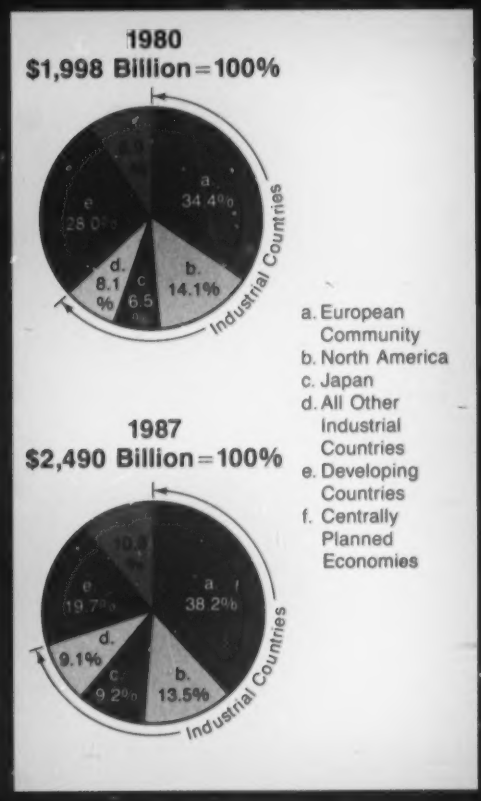
World Exports*



* Excluding centrally planned economies.

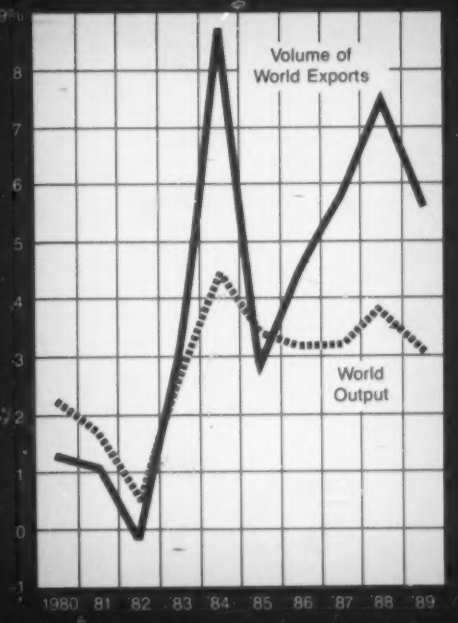
World Exports by Origin

1980 and 1970

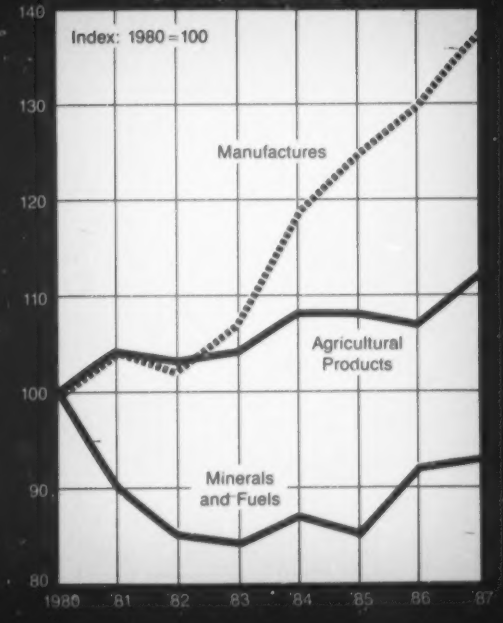


World Trade and Production

(Annual Change, in Percent)



Export Volume, by Major Category



Global Payments Imbalances

The total of all countries' current-account balances should, in theory, add up to zero since, as *The Economist* has noted, "there is no trade with the moon." Yet, for the past decade the global current account has shown a growing discrepancy; apparently, the world has been running a large deficit with itself. From a rough balance in the early 1970s, the world total swung into a negative balance of about $20 billion by 1978 and reached a peak of over $100 billion by 1982. This global deficit was more than halved in 1987, but it nudged close to $80 billion in 1988 and may grow by another $5 billion in 1989.

An IMF working party, set up in 1984, concluded that this discrepancy was concentrated mainly in nontrade items, especially investment income and official transfers. In 1987, the discrepancy on portfolio income alone was a $45 billion shortfall in credits relative to recorded debits. This reflects major changes in the nature and speed of international financial transactions in the past decade and greater integration of major financial markets (see page 16). These developments make it much harder to keep accurate track of financial assets.

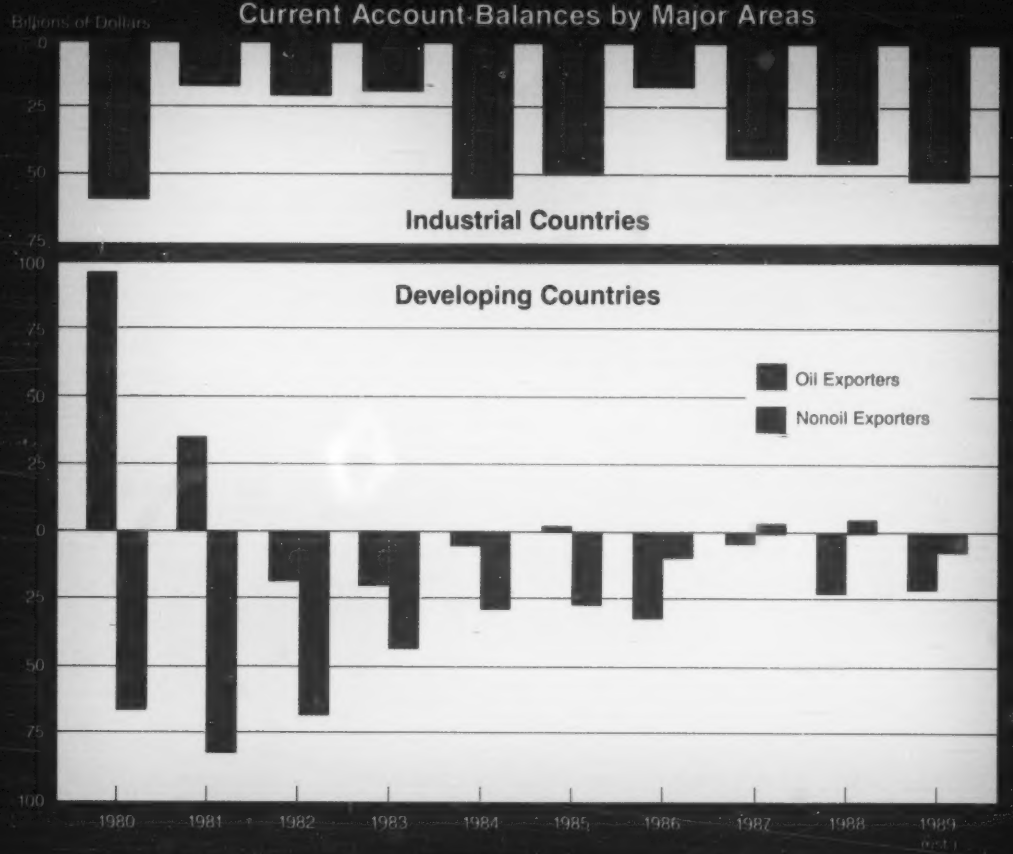
The geographic distribution of the global balance-of-payments discrepancy is likewise hard to pin down. The growth and persistence of the discrepancy indicates that either the deficits of some countries are being overstated or the surpluses of others understated. This has caused concern that large (but somewhat spurious) imbalances might lead to inappropriate policy decisions by some countries. It also casts some doubt on the true size of the international "indebtedness" of the United States.

Meanwhile, some encouraging shifts in export and import patterns are helping to reduce, or at least to stabilize, the external imbalances of the United States, Germany, and Japan relative to GNP. (In nominal terms, however, those imbalances are projected to widen in 1989-1990.) The U.S. current-account deficit is projected to decline from 3.4 percent of GNP in 1987 to 2.7 percent this year; Japan's surplus is expected to decline from 3.6 of GNP to 2.7 percent over the same period. The current surplus of Germany, on the other hand, is forecast to remain virtually unchanged relative to GNP, as worldwide demand for the types of capital goods in which Germany specializes remains brisk.

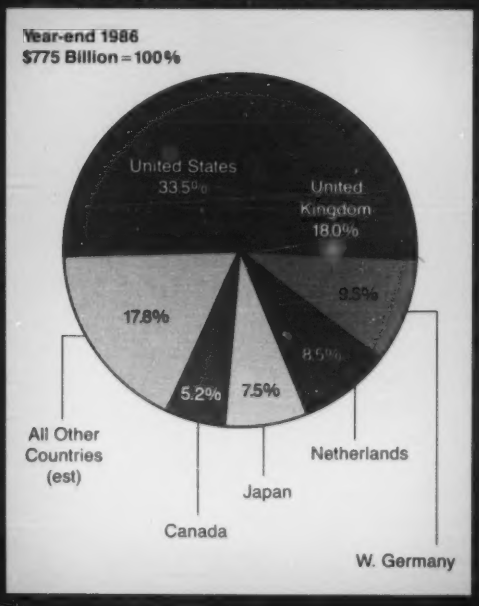
While the aggregate deficit of the developing countries is expected to widen somewhat over the next two years, the combined surplus of the four Asian NICs is projected to decline dramatically, from 10.8 percent of GNP in 1987 to 5.4 percent in 1990. These projections assume that the NICs will intensify efforts to liberalize imports, allow greater exchange-rate flexibility, and support domestic expansion.

Sources: International Monetary Fund; *The Economist*

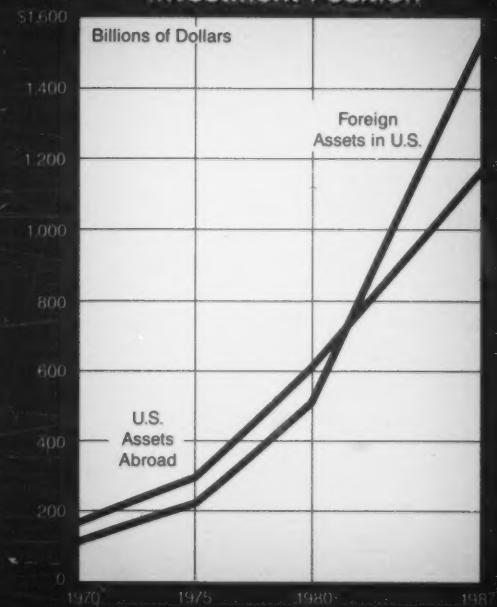
Current Account Balances by Major Areas



Worldwide Stock of Foreign Direct Investment



U.S. International Investment Position



Exchange Rates

Over the past few years, dissatisfaction with floating exchange rates has prompted growing demands for an overhaul of the international monetary system. Misalignments between currencies, which tend to occur when exchange rates fail to reflect underlying economic conditions, have created serious problems for the smooth functioning of the world economy. In addition, fluctuations in rates have tended to be significantly larger than justified by inflation differentials between the major countries. Major rate changes can therefore result in advantages or disadvantages that are not based on differences in economic efficiency.

The February 1987 Louvre Accord among the seven leading industrial countries signaled a strengthening of international monetary and exchange-rate cooperation. This accord established so-called target zones for the major currencies, i.e., the setting of upper and lower limits against the dollar, within which these currencies may fluctuate.

Target zones differ from a system of freely floating rates in two respects: (1) the authorities establish a target zone for some future period, and (2) they include the exchange rate in their monetary policy considerations to discourage it from moving outside its zone. Target zones also differ from "pure" floating in that the authorities are permitted to intervene in the exchange market and, indeed, are encouraged "to take a view" on the desirable level of the exchange rate. At the same time, there are no formal or rigid commitments to intervene under all circumstances. Finally, target zones can be reviewed and altered and there is no compelling need for domestic policy adjustments—as there is within the European Monetary System—should currencies stray beyond their prescribed limits. Despite some recent feelings to the contrary, the target-zone policy pursued over the past two-and-a-half years appears to have worked—and perhaps longer than originally expected.

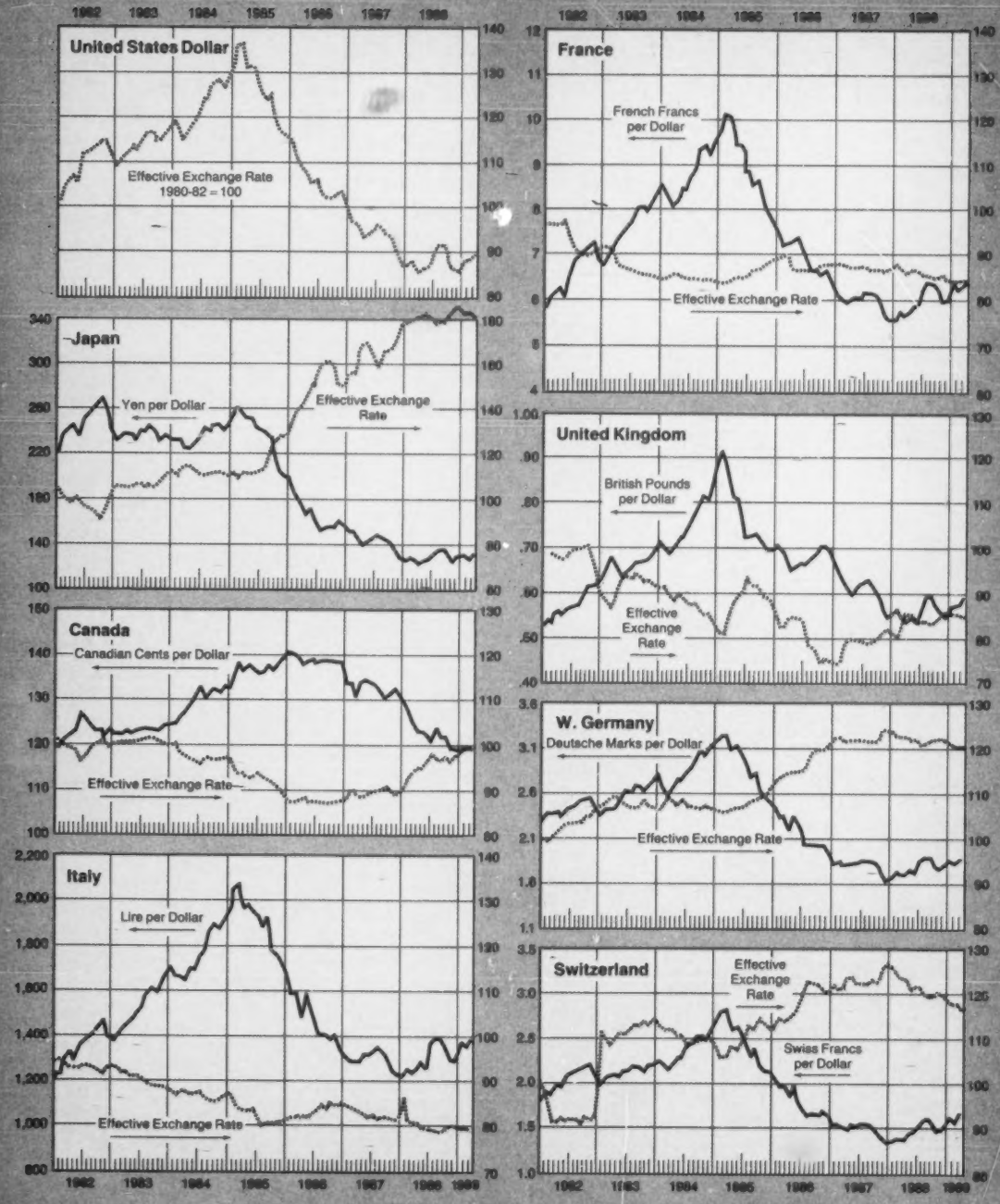
Looking at the diversity of actual exchange-rate arrangements currently in force, the system may appear to be basically one of fixed rates. At the end of 1988, 96 countries, almost all of them developing ones, were pegging their currencies either to the U.S. dollar, the French franc, or various types of currency baskets. Still, since the largest trading countries maintain either limited exchange-rate flexibility or completely free floating rates, in terms of world trade the system clearly is one of floating rates.

The currencies of four of the largest industrial countries—Canada, Japan, the United States, and the United Kingdom, which account for 30 percent of world trade—are "independently floating." If "floating trade" comprises the total of all trade that takes place at floating rates, between two-thirds and four-fifths of world trade is conducted at floating rates.

Sources: International Monetary Fund; Morgan Guaranty Trust Company

Foreign Exchange Rates

Indexes: 1980-82 = 100



Note: Effective exchange rate shows a currency's change against 15 other major currencies, using trilateral trade weights based on 1980 trade in manufactures.

World Financial Markets

Since the mid-1970s, financial markets in the major industrial countries, as well as in some newly industrializing nations, have expanded rapidly in both size and scope. This increased activity has been accompanied—and, indeed, has been fostered—by extensive structural changes in the markets, as well as by the widespread application of advanced information and communication technologies to financial transactions. The latter have reduced the cost and boosted the speed and efficiency of acquiring and evaluating information, making it possible to trade in a global market virtually around the clock.

Five broad trends characterize this expansion. First, the growth in financial markets has been more rapid than that of output, both in nominal and real terms. International bank lending and new international bond issues grew two-and-a-half times faster than GNP in the industrial countries during 1976-86. The expansion of securities markets is evidenced by the sharp rise in the ratio of the equity markets' capitalization to GNP in virtually all countries.

Second, the internationalization of financial markets has led to faster growth of offshore financial centers and greater foreign participation in domestic financial markets. It is also reflected in a rise in the proportion of total bank business accounted for by foreign loans and foreign security purchases.

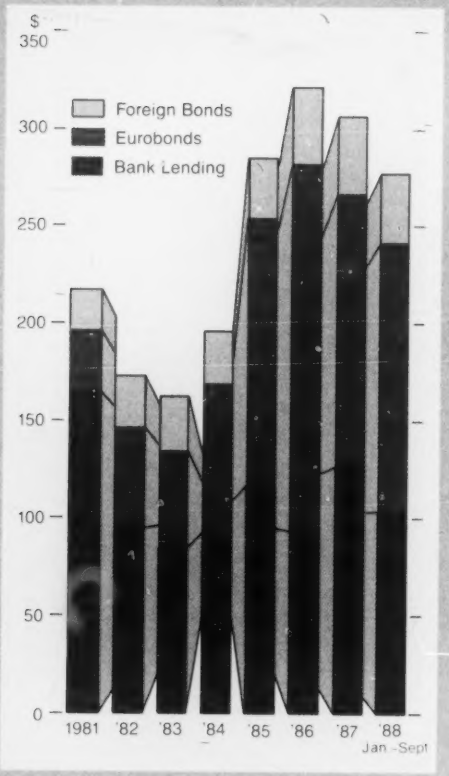
Third, "securitization" has changed the form in which banks provide credit. This procedure involves greater use of debt markets, with the lender holding a tradable claim on the borrower. A second form of securitization involves the packaging of assets that normally are not traded—bank loans, corporate receivables, and household debt—into tradable securities.

Fourth, deregulation of national financial markets has brought about the liberalization of cross-border financial flows, growing foreign participation in domestic markets, the introduction of new instruments, and the removal of pricing and other restrictions on financial institutions. Many of the innovations seen over this period, such as floating rate notes and interest rate swaps, originated in U.S. or Eurodollar markets before spreading to domestic markets in other financial centers.

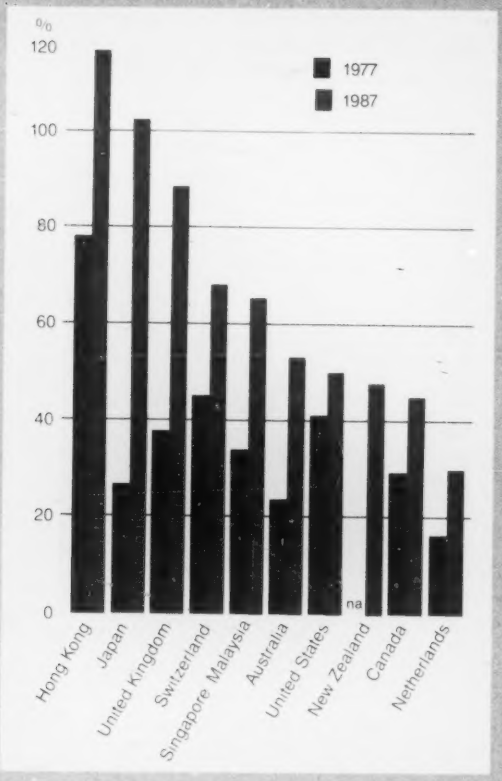
Finally, the strengthening of the supervisory and regulatory framework that had existed until the mid-1970s has become more urgent, as increasingly complex financial transactions have made credit, liquidity, and interest rate risks less transparent. Also, the great varity of new financial instruments has made it more difficult to apply and implement official liquidity and solvency guarantees. The response has been to reinforce the supervision of financial firms; to encourage the pricing of banks' activities in accordance with their risk; and to strive for greater convergence and coordination of supervisory and regulatory efforts among national authorities.

Sources: International Monetary Fund; Morgan Guaranty Trust Company; Morgan Stanley & Co.

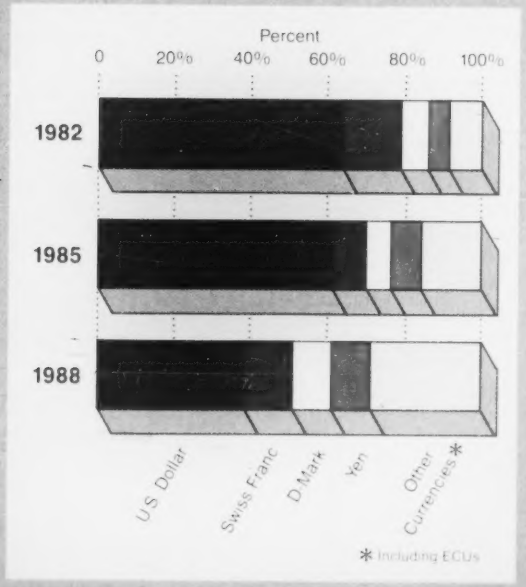
International Financial Markets
Billions of Dollars



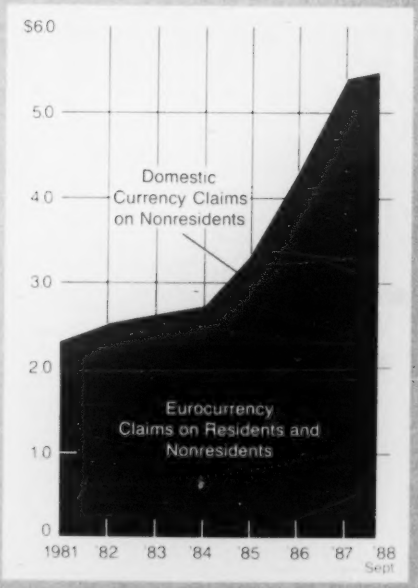
Stock Market Capitalization as Percent of Gross Domestic Product



International Bond Issues, by Currency



International Banking Market
Trillions of Dollars



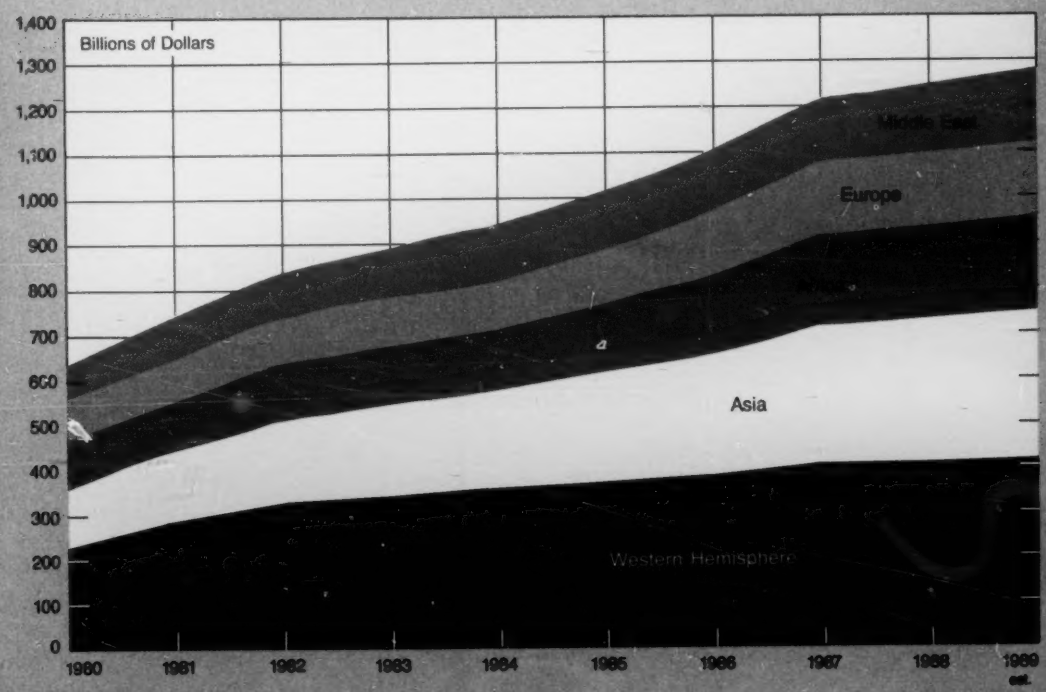
Developing Countries' Indebtedness

In the early 1980s, many developing countries encountered external debt-servicing difficulties and what became known as the "debt crisis" emerged. In the interim, the situation of some of the debtor countries has improved. In some cases, notably Chile and Mexico, external debt has been restructured and adjustment programs implemented. Overall, the 15 most heavily indebted countries also have strengthened their balance-of-payments positions.

As a result, in 1987 the overall ratio of debt to exports fell significantly for the first time since 1980 and declined further in 1988. The burden of debt service, relative to exports of goods and services, also declined to 19.6 percent from its 1986 record high of 23 percent, while the number of countries experiencing payments arrears decreased for the first time since 1975.

Nevertheless, a number of proposals for some form of debt relief reflect mounting frustration over genuine lack of progress in resolving the developing countries' debt problems. The strategy whereby 15 heavily indebted "middle-income" countries were to "grow" out of their debt difficulties, as outlined by U.S. Treasury Secretary James Baker in the fall of 1985, did not succeed for a number of reasons. Premature relaxation of adjustment efforts, difficulties in gaining a larger share of developed-country markets, and failure of financial support to reach projected levels all played a part.

External Debt of Developing Countries



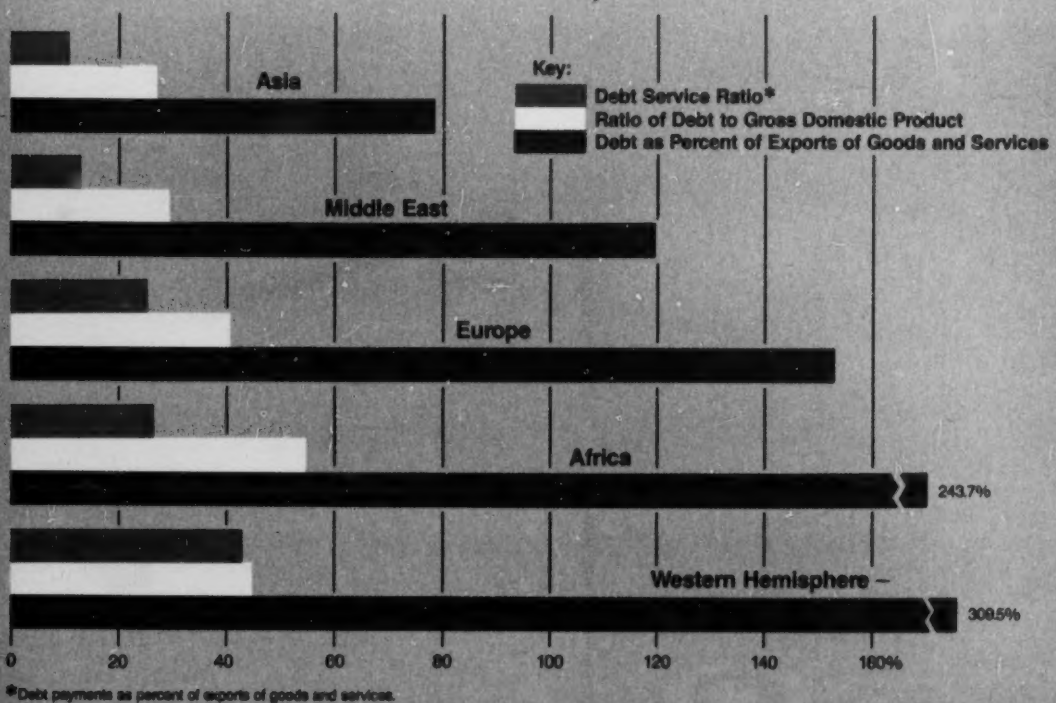
The initiative announced by Treasury Secretary Nicholas Brady in February 1989 was generally welcomed. It is seen as potentially easing several countries' debt-servicing burden through the combined use of the resources of the International Monetary Fund and the World Bank.

The Brady proposal incorporates some key elements contained in the earlier Baker initiative. First, since the situation of each debtor country is different, the problems of each need to be addressed separately, and second, domestic structural reform is viewed as a precondition for economic recovery. A corollary emphasized in the Brady proposal is that debt reduction should be accomplished through transactions that are voluntarily agreed to by debtors and creditors alike. This, in turn, would make it easier for the debtor countries to regain access to world capital markets.

However, while the Brady proposal has been characterized as "innovative," there also is concern that it may create unrealistic expectations on the part of some major borrowers. For instance, the sharp rise in the secondary market discounts on the debt of the most heavily indebted countries in recent years illustrates the markets' judgment on those countries' prospects. The average discount for this group at the end of 1988 was around 60 percent, with discounts for some countries' debt exceeding 90 percent.

Sources: International Monetary Fund; Morgan Guaranty Trust Company; World Bank

Developing Countries' External Debt in Perspective, 1988



*Debt payments as percent of exports of goods and services.

Financial Flows to Developing Countries

Over the past few years, financial flows to developing countries have been heavily dominated by official sources. From 1985 to 1988, official lenders—both governments and international institutions—provided some 80 percent of total flows, compared with about 35 percent in the early 1980s. Official Development Assistance (ODA) is

defined as any flow with a grant component above 25 percent that is directly related to the recipient country's economic development. (At one extreme, ODA could involve a loan at concessional or below-market rates of interest and, at the other, an outright grant of hard currency.)

In contrast, lending by the private sector—including commercial banks, nonbank financial institutions, and noninstitutional lenders—has remained weak since the mid-1980s, an obvious causalty of the debt crisis. Moreover, these data are somewhat imprecise. They are derived indirectly, since comprehensive private-sector flows, broken down by creditor, are not generally available.

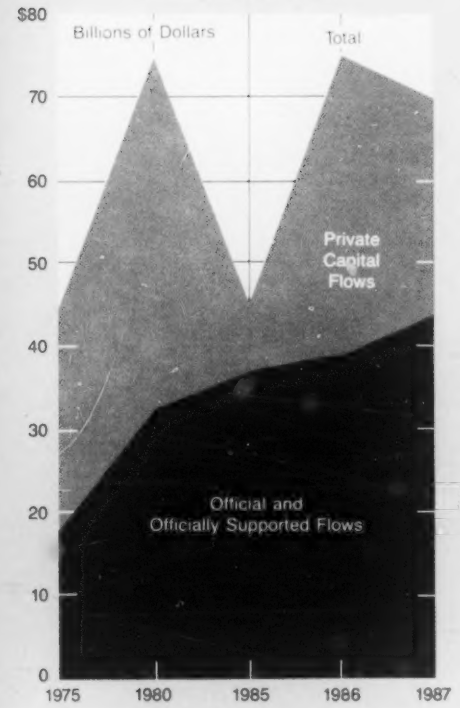
Each year, the Development Assistance Committee (DAC), an official OECD forum of 18 major donor countries, publishes comparative data that indicate clearly which DAC members exceed or fall short of the 0.7 percent ratio of ODA to GNP set as a target by the United Nations. Although the aggregate amount of ODA has risen steadily over the years, in both nominal and real terms, the ODA/GNP ratio for the entire group fell from 0.53 percent in 1961, the year the DAC was established, to 0.34 percent in the early 1970s. The overall ratio has remained fairly low since then, although a handful of the smaller DAC members have consistently managed to exceed the United Nations target.

Looking ahead to the 1990s, the DAC foresees a number of trends:

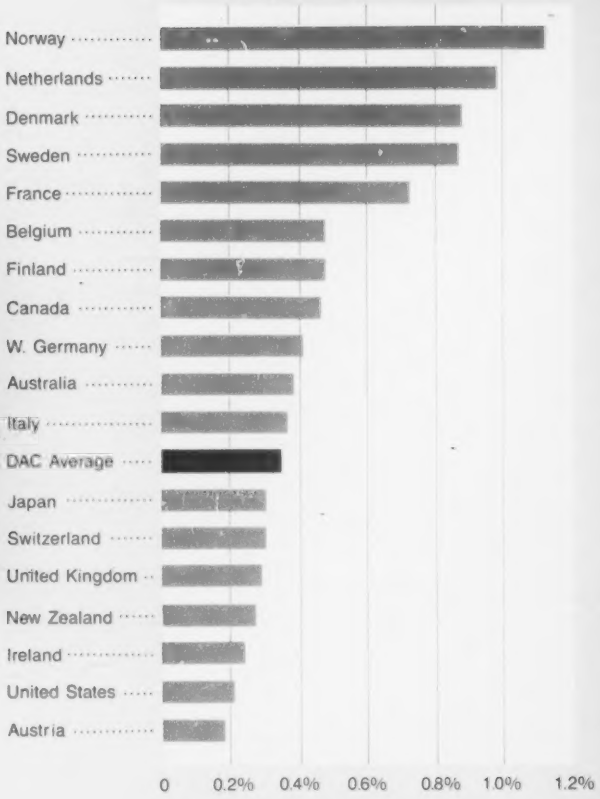
- Developing countries are likely to seek more direct assistance to their private sectors.
- Financial flows from private sources will gradually turn around from their present low levels, a process that has already started in Asia.
- Donors will continue to give highest priority to the lowest-income countries, especially in Africa. However, they will also heed the fact that most of the world's poorest live in countries—such as China, India, Nigeria, and the Philippines—that do not meet the UN criteria for "least developed."
- Donors may well rethink and revise their aid policy for some of the so-called upper-middle-income countries (with 1986 per capita GNP over $1,800) that are likely to move into the ranks of the newly industrializing countries (NICs).

Sources: Development Assistance Committee; World Bank

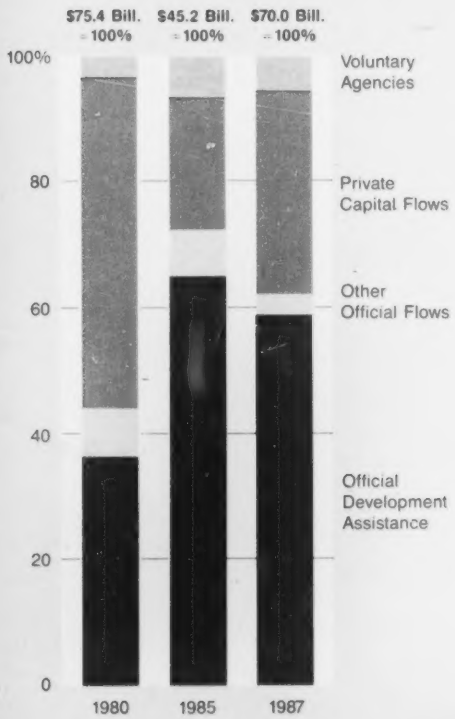
Total Net Flows



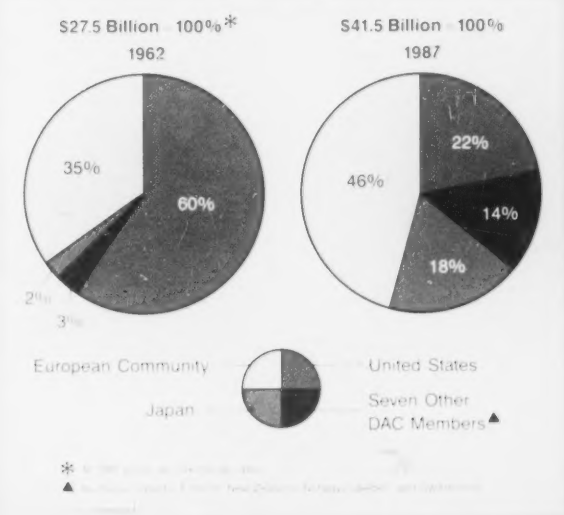
Official Development Assistance as Percent of Gross National Product, 1987



Type of Flows



Official Development Assistance by Major Countries



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Multinational Corporations

The 1980s have been characterized by major changes in the pattern of foreign direct investment and hence in the distribution of multinational corporations. The United States saw its position change from the leading source of MNC activity to the largest recipient. Outward investment by the United Kingdom began to exceed that of the United States in the first half of the decade. By the mid-1980s, Japan took the lead as the largest source of direct investment abroad.

Apart from Japan's emergence as a major exporter of capital, the heightened activity of developed-country MNCs during the 1980s reflects two additional broad-based factors. The first is the expansion of European MNCs, through both new investments and the acquisition of businesses outside their home countries. The second is the decline in U.S. foreign direct investment in the early part of the decade, as U.S. MNCs focused increasing attention on home market. However, with a single European market on the horizon after 1992, U.S. interests and investments in the EC are surging once more.

Foreign direct investment by corporations based in developing countries amounted to less than three percent of the world's stock of overseas investment in 1985. While most developing-country MNCs tend to be small, their number is fairly substantial. Seventeen of them have sales exceeding $1 billion, however, and ten of these are based in three countries—Korea (6), Brazil (2), and Mexico (2). A few oil-exporting countries with interests in petroleum refining and marketing likewise contain fairly large MNCs.

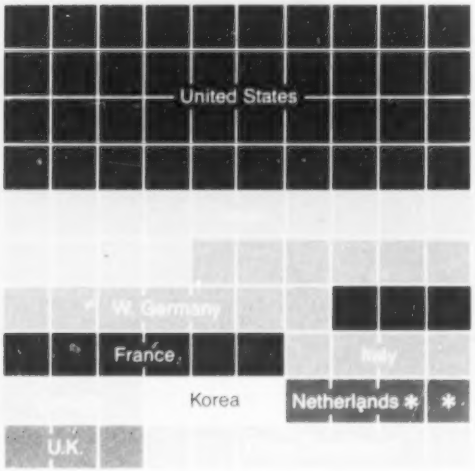
The increasing globalization of business has made itself felt in other ways as well. MNCs now account for a large share of their countries' foreign trade. This is especially true for the United States where trade between large companies and their overseas affiliates, trade between foreign-owned enterprises and their foreign parents, as well as trade between firms and their foreign subcontractors is of major importance. But this phenomenon is also becoming important for Japan, as affiliates of Japanese MNCs in developing countries export their output to the home country.

The globalization of business has been accompanied by the internationalization of banking and financial markets in general (see p. 16). Again, in line with Japan's rise to international creditor status, the list of the world's largest banks is now dominated by Japanese institutions as compared to as recently as ten years ago, when the list was headed by U.S. banks.

Sources: *The Banker*; *Fortune*; United Nations

World's 100 Largest Industrial Corporations, 1987

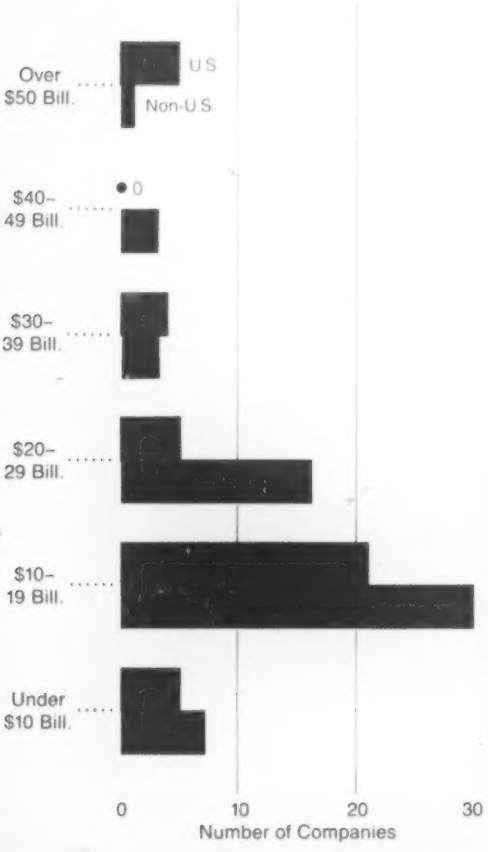
By Nationality



* U.K.-Netherlands

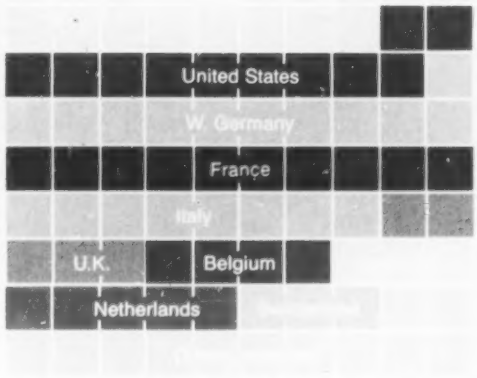
▲ Brazil, Kuwait, Mexico, Spain, Sweden and Switzerland

By Sales



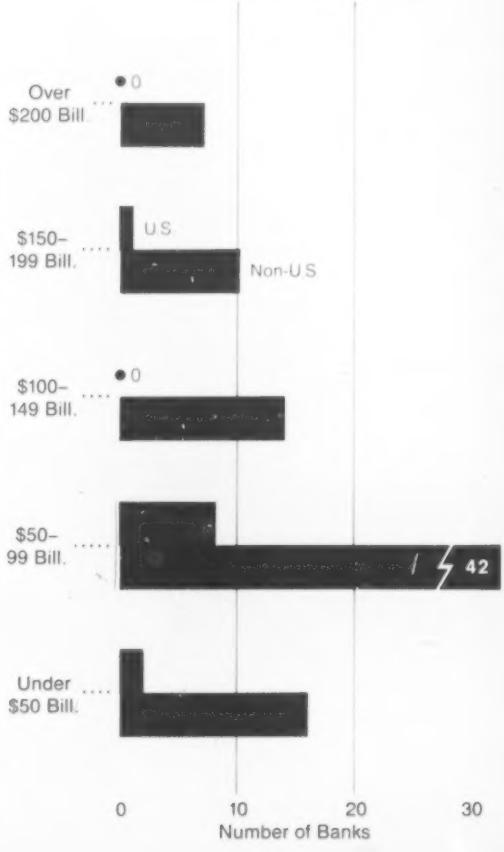
World's 100 Largest Banks, 1987

By Nationality



▲ Austria, Australia, Brazil, China, Hong Kong, India, Iran, Iraq, Spain and Sweden

By Assets



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